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CHARLES ELMORE CROPLEY

IN THE

Supreme Court of the United States

OCTOBER TERM, 1944.

No. 842

A. G. HORTON AND M. K. BUCHANAN, Trading as Mechanical Ice Tray Company and I. C. E. Corporation, *Petitioners*,

v.

GENERAL MOTORS CORPORATION, *Respondents*.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF.

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PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States:

Your petitioners, A. G. Horton and M. K. Buchanan, partners trading as Mechanical Ice Tray Company,[1] and I. C. E.

[1] Originally the interest of these parties was owned by Mechanical Ice Tray Corporation, a corporation of the State of Virginia, and the record and opinion are so entitled, but the interest of the Corporation was assigned to the individuals, while the case was pending in the Court of Appeals, and they were substituted for the Corporation by an order dated May 23, 1944 (R. 338).

Corporation, respectfully pray for a writ of certiorari to the Circuit Court of Appeals for the Second Circuit, to review a decree of that court of December 8, 1944 (R. 350-1). A certified transcript of the Record in the case, including the proceeding in said Circuit Court of Appeals, is furnished herewith in accordance with Rule 38 of the Rules of this Court.

SUMMARY STATEMENT OF THE MATTER INVOLVED.

The parties to this suit entered into an agreement dated April 1, 1936 (Exh. 1, R. 144-163) under which petitioners granted to respondent an exclusive license,[2] under a group of United States patents relating to ice trays for mechanical refrigerators. The agreement provided for the payment of royalties on any device covered by any of the licensed patents (Paragraph 6(a), R. 152) and contained a provision (Paragraph Eleventh (b) printed in the margin)[3]

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[2] There was an outstanding non-exclusive license to Westinghouse, but the Court of Appeals, affirming the District Court, said: "We think this license made the defendant (respondent) an exclusive licensee though it is true that the non-exclusive license to Westinghouse remained in effect." (R. 2409)

[3] "(b) It is understood and agreed that in the event any of the claims of any of said patents are construed or held invalid by a decision of a court of competent and final jurisdiction, or by an inferior court from whose decree no appeal is taken within the time required by law, then the requirement to pay royalties under this license with respect to any such claim or claims shall be interpreted in conformity with the court's decision as to the scope or valility of such claims of said patents so that no royalty shall be payable under such claims after the date of such decision upon any ice tray which has heretofore been deemed made under said claims of any such patents and hence subject to royalties hereunder solely because they fell within the claims so held invalid or construed unless and until the Supreme Court of the United States reverses said decision, whereupon Inland shall be obligated to assume and continue the payment of royalty under such claims at and from the date of the decision of the said last-mentioned court, and the same shall apply to any claim or claims broader in scope in the elements so construed than those passed upon by the court

that in determining the requirement to pay royalties under the license the patent claims would be interpreted in conformity with any final judicial decision as to their scope or validity. Prior to April 1, 1940, in litigation against an alleged infringer, a decision was handed down (*Mechanical v. Abraham & Straus,* 31 F. Supp. 938) construing certain claims of one of the licensed patents (Patent 1,893,535).

On April 1, 1940 respondent discontinued payment of royalties on certain trays, called types 2 and 3, on which it had previously paid royalties, asserting that, under the provisions of paragraph 11 (b), any obligation to pay royalties on those devices was terminated by the judicial construction. It continued for a time to manufacture and sell and to pay royalties on a type 7 tray admitted to be within the adjudicated patent claims, but in November 1940 it began to substitute for type 7 a modified tray, called type 4, on which it paid no royalty, asserting as to type 4 also that it was relieved of obligation to pay royalties under the license by the aforesaid contract provision and judicial interpretation.

Although respondent had the right to cancel the license or surrender the exclusive license and retain a non-exclusive license (R. 156, 157) it continued to hold on to the exclusive license until after the decision of the district court in this case in the fall of 1943, thus shelving the patents during this period and preventing petitioners from practicing the inventions or from exploiting them by licensing others.

Petitioner brought suit against respondent in the Southern District of New York, alleging *inter-alia* that the introduction of the new type 4 tray superseding the patented type 7 and also the continued marketing of trays 2 and 3,

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insofar as the decision of said court shall be unfavorable to Mechanical. Nothing in this paragraph contained shall, however, be construed to relieve Inland of its obligations to pay royalties under claims not so construed, not so held invalid or that are narrower in scope as to the elements so construed than those passed upon by the court as aforesaid."

was in violation of respondent's obligation as exclusive licensee to exploit the licensed inventions for the mutual benefit of both parties and to refrain from marketing commercially equivalent devices outside the scope of the claims of the patents in competition with or in place of the licensed devices.

Respondent denied any implied obligation to exploit the licensed inventions, asserting that if any such implied obligation exists, it is void, contrary to public policy, invalid and unenforceable.

The District Court (R. 298) found that none of the trays 2, 3 or 4 was within the scope of the patent claims as judicially interpreted,[4] but held that respondent was, so long as it retained the exclusive license, under an implied obligation of good faith to exploit the licensed trays and to refrain from marketing commercially equivalent devices, outside the scope of the patent claims, in competition with or in place of the licensed devices; that respondent's type 7 tray was the commercial equivalent of its type 4 tray; that the action of respondent in making the change from type 7 tray to its type 4 tray was not attributable to any competition but solely to avoid the payment of royalties (R. 303); that respondent's substitution of the type 4 tray for the patented type 7 tray was a violation of its obligation to exploit as exclusive licensee for which petitioner was entitled to damages measured by the royalty (R. 305); but that the type 2 and type 3 trays were excluded from this implied obligation by the terms of paragraph Eleventh (b) of the license (R. 283).

The Court of Appeals by a divided court on August 26, 1944 affirmed the findings of the district court with respect to type 2 and 3 and reversed with respect to type 4 tray, thus denying petitioner all relief.

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[4] As to Reissue 18,819, to which paragraph 11(b) has no application because the reissue had not been adjudicated, the Court, affirming the district court, also held that no royalties were due on these trays because they do not have the distinguishing features of the reissue claims.

The Court recognized the existence of a well established rule imposing on an exclusive licensee an implied covenant to exploit the licensed products in good faith so as to produce royalty income. It recognized that this is not a rule limited to patent agreements but is of general application to co-adventurers, one of whom entrusts the exploitation of his property exclusively to another. The court also noted the well recognized exception that the exclusive licensee may without a breach of this obligation adopt an unlicensed (and therefore royalty free) product if it is commercially superior and its adoption is necessary to meet or anticipate competition. It found however that there were no circumstances here to bring into play this exception to the rule. It found that the licensed tray type 7 was the commercial equivalent of unlicensed trays type 2, 3 and 4 and that there was no competition to justify respondent's failure to exploit the licensed tray in good faith. Although the circumstances justifying the application of the rule of implied covenant were thus found to be present, the Court refused to give it effect because of the provisions of Paragraph Eleventh (b) of the license agreement.

The majority opinion first expresses doubt whether that part of an exclusive licensee's duty to exploit the licensed trays in good faith has survived in a practical sense the *Mercoid* case[5] and then holds that whatever may be left of the rule is not applicable in this case. The Court construed paragraph Eleventh (b) as an agreement by the parties that the exclusive licensee might make and sell whatever kinds of tray are royalty-free.

The Court said (R. 340):

> "Paragraph Eleventh (b) of the license shows that the parties contemplated that their construction of the patent claims might be narrowed by court decision and that, if they were so narrowed, devices which the defendant had made and on which it had paid running royalties could thereafter be manufactured and sold

[5] Mercoid Corp. v. Mid-Continent etc. Co., 320 U. S. 661; see also Mercoid Corp. v. Minneapolis-Honeywell etc. Co., 320 U. S. 680.

> royalty-free. The trays of type 2 and 3 were in this category. The continued manufacture, use and sale of them without payment of running royalties was, therefore, permissible in accordance with the express provisions of the license and no obligation to the contrary can be implied."
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> * * * * * * * * *
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> "* * * The exercise of good faith in exploiting the licensed patents did not require the defendant to refrain from doing whatever the plaintiffs had expressly agreed that it might do. No obligation not to manufacture and sell whatever kind of trays the license gave the defendant the right so to manufacture and sell can be implied and of course there can be no breach of a non-existent obligation."

This construction of paragraph Eleventh (b) as a grant by the licensee to the licensor of a "right so to manufacture" things not covered by the patent claims when the scope of those claims has been more precisely defined by judicial interpretation is the thing that gives rise to the novel question which this Court is now asked to review.

Paragraph Eleventh (b) stands in the license agreement as a continuing means of bringing the obligation of the licensee to pay royalty under the claims of the patent (expressed in paragraph Sixth (a), R. 152) always into accord with the judicially interpreted scope of the patents. Until the claims have been interpreted they stand on their terms as the definition of the things as to which the licensee must pay the licensor for the use of the monopoly. The effect of paragraph Eleventh (b) is only to make the obligation of paragraph Sixth (a) more definite when judicial interpretation has made the scope of the monopoly more definite.

When the Court of Appeals construes paragraph Eleventh (b) as a grant of right to manufacture without payment of royalty things not covered by the judicially interpreted claims, it in effect construes paragraph Sixth (a) as a grant of right to manufacture without payment of royalty things not covered by the patent claims as they stood in the unadjudicated patent.

The interpretation of either paragraph as a grant of right to manufacture unpatented things must have the effect to abrogate the implied obligation imposed on the exclusive licensee as a matter of public policy—the obligation to deal with the licensor in good faith.

Thus the Decision of the Second Circuit Court of Appeals in this case gives rise to the novel question, of general significance in the administration of the patent law, whether the implied obligation of an exclusive licensee to exploit the licensed devices in good faith and to refrain from entering into competition with them to the detriment of the licensor is abrogated by the normal provision in the license agreement that the obligation to pay royalty under the agreement is measured by the scope of the patent monopoly; and, more specifically, that the obligation of good faith is so abrogated by a provision in the license agreement that the extent of the requirement to pay royalty under the license shall conform to any final judicial interpretation of the scope and validity of the patent claims.

Because this conclusion was reached by the Court of Appeals after expressing doubt whether the heretofore recognized obligation of the exclusive license under a patent has survived in a practical sense the decision of this Court in the *Mercoid* case, the further question is raised whether this obligation of good faith is repugnant to any principle announced in that case.

JURISDICTION.

The suit is based on diversity of citizenship and an amount in controversy, exclusive of interest and costs, exceeding $3000. (Judicial Code, Section 24 (1), 28 U. S. C., Sec. 41.)

The jurisdiction of this Court is invoked under Section 240 of the Judicial Code as amended by the Act of February 13, 1925 (28 U. S. C., Sec. 347).

The judgment your petitioners seek to have reviewed is dated December 8, 1944.

Issuance of the mandate has been stayed by order of the Circuit Court of Appeals to permit the filing of this Petition for Writ of Certiorari.

THE QUESTION INVOLVED.

1. Is the rule that an exclusive licensee is under an implied obligation to exploit the patent in good faith and not to market for its own profit, and to the detriment of the licensor, devices not covered by the patent which compete with the licensed devices (subject only to the limitation that the exclusive licensee may exploit such devices to meet adverse competition from others) waived because the agreement makes the scope of the royalty obligation co-extensive with the scope of the licensed patents?

2. Is this rule waived by a provision in the license agreement that a judicial construction of any licensed patent shall govern as between the parties as to the scope of the patent construed and the royalty obligation thereunder?

3. Is this rule repugnant to any principle announced in the *Mercoid* case?

REASONS FOR ALLOWANCE OF THE WRIT.

1. The court below refused to enforce an implied covenant of good faith that has not before been so nullified and that is of fundamental importance to the legal relationship of licensor to exclusive licensee. The court acted on grounds which in direct application make the implied covenant a nullity in any exclusive patent license. A major change in the patent law has been made on what seems a clear error going to the fundamentals of this obligation of good faith.

2. The matter is of importance to the administration of the patent law. It bears squarely on the subject of proper use of patent rights and proper dealings with respect to such rights. The existence or abrogation of this covenant heretofore implicit in exclusive licenses is sure to affect the willingness of patent owners to grant such licenses; its

abrogation will impede such licensing and, because prospective licensees frequently will take no other form of license, it will impede the process of getting inventions into use.

3. At a time when the doctrine of the *Paper Bag* case[6] is being assailed and weakened in the interest of preventing patents from being shelved, this decision enthrones the dog-in-the-manger right in an important area of patent dealings from which it has heretofore been excluded.

4. The question with respect to the *Mercoid* case in relation to this implied covenant to exploit is an important one which should be decided. The decision below creates an uncertainty in the law which should be eliminated.

5. The case was decided by a divided court and with respect to the question on which the writ is sought the dissenting opinion is in agreement with that of the district judge.

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[6] Continental Paper Bag Co. v. Eastern Paper Bag Co., 210 U. S. 405.